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# Corporate Predators Attack Environmental Regulations: It's Time to Arbitrate Claims Filed under NAFTA's Chapter 11

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# CORPORATE PREDATORS ATTACK ENVIRONMENTAL REGULATIONS: IT'S TIME TO ARBITRATE CLAIMS FILED UNDER NAFTA'S CHAPTER 11

## I. INTRODUCTION

The North American Free Trade Agreement (NAFTA)<sup>1</sup> is an economic agreement between the United States, Canada, and Mexico designed to increase regional trade and economic competitiveness in the world economy.<sup>2</sup> Given Mexico's seventy-year history of expropriating foreign assets,<sup>3</sup> ensuring adequate investor protection was crucial to NAFTA's success. Accordingly, Chapter 11 of NAFTA, the investor-to-state dispute resolution provision, provides that no Party signatory may nationalize or expropriate an investor's assets except for a public purpose and upon payment of adequate compensation.<sup>4</sup>

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1. The North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 32 I.L.M. 605 (1993) (entered into force Jan. 1, 1994) [hereinafter NAFTA].

2. See Noemi Gal-Or, *Private Party Direct Access: A Comparison of the NAFTA and the EU Disciplines*, 21 B.C. INT'L & COMP. L. REV. 1, 5 (1998). NAFTA created a market of 370 million people and \$6.5 trillion in production. See Jonathan I. Miller, Comment, *Prospects for Satisfactory Dispute Resolution of Private Commercial Disputes Under the North American Free Trade Agreement*, 21 PEPP. L. REV. 1313, 1315 (1994).

3. See generally Gloria L. Sandrino, *The Nafta Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259 (1994) (discussing Mexico's seventy-year history of expropriating foreign assets); see also *infra* Part II (discussing the same).

4. According to NAFTA Article 1110:

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and [international law]; and
- (d) on payment of compensation . . .

NAFTA art. 1110(1), *supra* note 1, at 641-642. The concept of expropriation is described using words such as "dispossession," "taking," "deprivation," or "privation." J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 473 n.17 (1999) (quoting RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 98 (1995)). Regulatory takings are referred to as "indirect expropriation," "disguised expropriation," or "creeping expropriation." *Id.* at 517 & n.236 (quoting M. SORNARAJAH, *THE INTERNATIONAL*

Recently, several corporations have used Chapter 11 to challenge legitimate domestic laws, regulations, and policies, including environmental regulations.<sup>5</sup> Critics contend that Chapter 11 is "not so much about trade as about creating powerful new rights for corporations and investors at the expense of the public interest and democratic governance."<sup>6</sup> Moreover, these critics claim that early Chapter 11 claims illustrate "how global corporate predators, whether U.S., Canadian or Mexican, can use NAFTA as a giant loophole to evade the rule of law and our system of jurisprudence."<sup>7</sup> This assessment leads some to conclude that Chapter 11 is "the latest, and one of the strongest, reasons for the U[nited] S[tates] to withdraw from NAFTA."<sup>8</sup>

LAW ON FOREIGN INVESTMENT 282 (1994)). The term "investment" includes an "enterprise;" securities, loans to, or interest in the assets or profits of an enterprise; tangible or intangible real estate or other property acquired for economic benefit; and interests from the commitment of capital or other resources to economic activities." *Id.* at 474 n.25.

5. See *infra* Part VI (discussing two of the more controversial environmental claims).

6. Statement by Lori Wallach, Director, Public Citizen's Global Trade Watch, *NAFTA "Investor-to-State" Provision Creates Giant Loophole for Companies to Evade Justice* (Nov. 24, 1998) <<http://www.citizen.org/Press/pr-gtw7.htm>>.

7. Public Citizen, *NAFTA's Birthday Bombshell, Corporate Predator Found Liable for Malicious and Fraudulent Business Practices in Mississippi Uses NAFTA to Attack Legal System* (Nov. 24, 1998) <<http://www.citizen.org/Press/pr-gtw5.htm>> (quoting Public Citizen President Joan Claybrook).

8. Statement of Public Citizen President Joan Claybrook, *NAFTA Challenge to Mississippi Jury Verdict Threatens U.S. Justice System* (Nov. 24, 1998) <<http://www.citizen.org/Press/pr-gtw6.htm>>.

Chapter 11 has created significant anxiety globally. Until recently, Chapter 11 served as the model for the worldwide expansion of investment protection in the now-defunct Multilateral Agreement on Investment (MAI). See Wagner, *supra* note 4, at 467 (referring to the MAI, Negotiating Text (as of Apr. 24, 1998), available at Organisation for Economic Co-operation and Development (OECD), *The Multilateral Agreement on Investment, The MAI Negotiating Text* (visited Sept. 3, 2000) <<http://www.oecd.org/daff/investment/fdi/mai/maitema.pdf>>). The Secretary of the MAI Negotiating Group noted that one Chapter 11 claim in particular, the Ethyl-Canada dispute, see Part VI, *infra*, "caused MAI negotiators to 'think twice before copying the expropriation provisions of the NAFTA.'" Wagner, *supra* note 4, at 483 n.73. Also, a group of thirty Non-Governmental Organizations (NGOs) released a statement calling for national governments to "[e]liminate the investor state dispute resolution mechanism . . . [and the] [] expropriation provision so that investors are not guaranteed an absolute right to compensation for expropriation." Samrat Ganguly, Note, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health*, 38 COLUM. J. TRANSNAT'L L. 113, 128-129 n.73 (1999). "In October 1998, as a result of 'significant concerns' regarding the [MAI], including 'issues of sovereignty, protection of labour rights and environment, culture and other important matters,' the OECD indefinitely suspended further negotiations on the agreement." Wagner, *supra* note 4, at 481.

This Comment concludes otherwise. Foreign corporations have successfully used Chapter 11 to extort compensation payments only because Party governments have settled Chapter 11 claims, rather than arbitrate them. Part II of this Comment begins with a discussion of the history of foreign direct investment in Mexico, which demonstrates the need for adequate investor protection. Part III introduces Chapter 11's predecessor, the U.S. Bilateral Investment Treaty (BIT) Program, which is the primary vehicle the United States employs to protect investments globally. Part IV provides an overview of Chapter 11 basics. Part V discusses international law as applied to governmental regulations, and through an examination of relevant authorities, concludes that contrary to critics' claims, Chapter 11 does not require that Party governments pay compensation to foreign corporations for the negative economic impact of environmental regulations. Part VI illustrates the Chapter 11 controversy by reviewing two of the more controversial claims. Part VII evaluates a few of the most common "solutions" legal scholars advance. Finally, Part VIII concludes that remedial measures are not necessary—instead of settling Chapter 11 claims, it's time to arbitrate them.

## II. THE HISTORY OF FOREIGN DIRECT INVESTMENT IN MEXICO

U.S. and Canadian negotiators incorporated Chapter 11 into NAFTA to prevent Mexico from expropriating new foreign investment.<sup>9</sup> "The problems with Mexico . . . made the dispute resolution provision an important negotiation goal for the United States."<sup>10</sup> These problems began in the early 1900s, when the Mexican Government encouraged foreign investment to facilitate development of the Mexican economy.<sup>11</sup> In addition to creating an infusion of new capital and generating greater tax revenue, government officials believed that substantial foreign investment would allow Mexico to obtain and adopt new technology.<sup>12</sup> As a result of Mexico's investor-friendly policy, foreign investment

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9. See *NAFTA: The Sting in Trade's Tail*, *ECONOMIST*, Apr. 18, 1998, at 70, 71; see also generally Sandrino, *supra* note 3 (describing Mexico's history of expropriating foreign assets from the early 1900s to its adoption of NAFTA).

10. Kristin L. Oelstrom, Note, *A Treaty for the Future: The Dispute Settlement Mechanisms of the NAFTA*, 25 *LAW & POL'Y INT'L BUS.* 783, 801 (1994).

11. See Sandrino, *supra* note 3, at 298.

12. See *id.*

poured into railroad construction, mining, public utilities, real estate, banking, manufacturing, and commerce.<sup>13</sup>

Within a decade, the Mexican economy thrived, but foreign nationals owned more than half the country's total wealth.<sup>14</sup> At the time, Mexican social theorists and policy-makers blamed foreigners for Mexico's extreme economic dependence and its political and economic underdevelopment.<sup>15</sup> These anti-foreign sentiments fueled the Mexican Revolution of 1910.<sup>16</sup> In 1917, the Revolutionaries adopted a new Constitution that placed severe restraints on foreign investment and foreign land ownership.<sup>17</sup> Additionally, the Mexican Government implemented policies designed to harass foreign investors and began deliberately expropriating and nationalizing foreign-owned assets.<sup>18</sup>

The most dramatic and often-cited example of these policies is Mexico's nationalization of the entire U.S. and British-owned oil industry in 1938, which, at the time, was the second largest oil industry in the world.<sup>19</sup> Rather than declare war against Mexico,

13. See *id.* at 280.

14. See *id.* at 281.

15. See *id.* at 271-272.

16. See *id.* at 281.

17. See *id.* (referring to MEX. CONST. (1917), translated in XII CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 11 (Albert P. Blaustein & Gisbert H. Flanz eds., 1988)). Article 27 of the 1917 Mexican Constitution provides:

Ownership of the lands and waters within the boundaries of the national territory is vested originally in the Nation, which has had, and has, the right to transfer title thereof to private persons, thereby constituting private property.

Private property shall not be expropriated except for reasons of public use and subject to payment of indemnity.

The Nation shall at all times have the right to impose on private property such limitations as the public interest may demand, as well as the right to regulate the utilization of natural resources which are susceptible of appropriation, in order to conserve them to ensure a more equitable distribution of public wealth, to attain a well-balanced development of the country and improvement of the living conditions of the rural and urban population.

MEX. CONST. tit. I, ch. I, art. 27, translated in XII CONSTITUTIONS OF THE COUNTRIES OF THE WORLD, *supra*, at 23. The Article 27 provision is a codification of the "Calvo Doctrine." See Justine Daly, *Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico After the NAFTA*, 25 ST. MARY'S L.J. 1147, 1150, 1163-1165 (1994). For a discussion of the Calvo Doctrine, see *infra* text accompanying notes 22-23.

18. See Sandrino, *supra* note 3, at 283-300.

19. See *id.* at 287. The expropriation began when Mexican workers, frustrated with low wages and poor working conditions, went on strike in 1937. See *id.* at 290 n.129. An industrial arbitration board heard the dispute, decided the workers' grievances were legitimate, and awarded them a one-third increase in wages. See *id.* The oil companies

the U.S. and British Governments asserted that traditional principles of international law required that Mexico pay the investors prompt, adequate, and effective compensation.<sup>20</sup> The Mexican Government refused to pay, claiming that expropriation was within Mexico's rights as a sovereign nation.<sup>21</sup> The Mexican Government justified its actions (legally) by asserting the Calvo Doctrine, pursuant to which a government may nationalize or expropriate any foreign investment according to domestic law and policy (which may not require compensation), rather than international norms (which require prompt, adequate, and effective compensation).<sup>22</sup> The Calvo Doctrine further stipulates that no foreign state may intervene, diplomatically or otherwise, to enforce its citizens' claims.<sup>23</sup>

More troublesome than Mexico's domestic policy was its leadership and advocacy in the United Nations. In 1974, developing states, having acquired a majority in the General Assembly, enacted the Charter of Economic Rights and Duties of States (CERDS)<sup>24</sup>—Article 2 of which is considered “a classic restatement of the Calvo Doctrine.”<sup>25</sup> Under Article 2, if a dispute arises over any foreign investment matter, the dispute shall be decided according to *national/domestic* judicial or arbitral procedures.<sup>26</sup> Industrialized states staunchly opposed this

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appealed the decision to the Mexican Supreme Court, which upheld the decision. *See id.* Defiantly, the companies refused to obey the Court. *See id.* In response, Mexican President Lazaro Cárdenas promptly signed a decree nationalizing the companies' assets. *See id.*

20. *See id.* at 290–291.

21. *See id.* at 291. According to the Mexican Government:

(a) nationalization was a legitimate exercise of its sovereign right to restructure its economy; [and] (b) the compensation demanded by the United States would constitute an inadmissible fetter on this right: “[T]he future of the nation could not be halted by the impossibility of immediately paying the value of the property belonging to a small number of foreigners who only seek a lucrative end;” . . . .

*Id.*

22. *See id.* at 268.

23. *See id.*

24. CHARTER OF ECONOMIC RIGHTS AND DUTIES OF STATES, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 50, U.N. Doc. A/9631 (1975), *reprinted in* 14 I.L.M. 251 (1975).

25. Sandrino, *supra* note 3, at 274 (internal quotation marks omitted).

26. *See id.* at 275.

position, arguing that the correct approach for settling foreign investment disputes involves *international* arbitration or adjudication and requires payment of "prompt, adequate, and effective compensation."<sup>27</sup>

In the aftermath of the CERDS, gross foreign direct investment in the Third World declined drastically from \$13 billion in 1981 to \$9.5 billion in 1986.<sup>28</sup> The decline was due, in part, to the perception that legal standards for protecting foreign investment in Third World states were inadequate.<sup>29</sup>

### III. BILATERAL INVESTMENT TREATIES (BITs)

The United States launched the BIT program in 1977.<sup>30</sup> The program's goal was to circumvent the CERDS by creating a network of treaties with other sovereign nations to embrace the "prompt, adequate, and effective" standard of compensation.<sup>31</sup> The United States was hugely successful in this endeavor—as of March 1998, there were 1300 BITs.<sup>32</sup>

The primary purpose of a BIT is to protect against expropriation.<sup>33</sup> U.S. BITs provide protection against expropriation "in accordance with international law."<sup>34</sup> Similarly, Article 1105(1) of NAFTA provides: "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."<sup>35</sup> Because NAFTA is an agreement between three countries, it is essentially a multilateral BIT governing investor protection.

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27. *Id.* at 275 n.47.

28. *See id.* at 277.

29. *See id.*

30. *See generally* Kenneth J. Vandeveld, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH. J. INT'L L. 621 (1993) (describing the evolution of the BIT program from 1977 to the present).

31. *See id.* at 625.

32. *See* Wagner, *supra* note 4, at 472.

33. *See* Vandeveld, *supra* note 30, at 625.

34. U.S. DEPARTMENT OF STATE, FACT SHEET, U.S. BILATERAL INVESTMENT TREATY PROGRAM (May 5, 1999) <[http://www.state.gov/www/issues/economic/ifd\\_bitprogram.html](http://www.state.gov/www/issues/economic/ifd_bitprogram.html)>.

35. NAFTA art. 1105(1), *supra* note 1, at 639.

## IV. CHAPTER 11 BASICS

Chapter 11 of NAFTA protects investors from uncompensated government expropriation. In sum, it provides that: (1) private investors have standing to force a foreign government to engage in international arbitration under the rules of the International Centre for the Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL);<sup>36</sup> (2) an investor may bring a Chapter 11 claim directly before an international arbitral tribunal thereby bypassing the domestic courts of the host government;<sup>37</sup> (3) all proceedings are confidential;<sup>38</sup> (4) each party chooses an arbitrator and the presiding arbitrator is chosen by mutual agreement (a majority of the votes of the arbitrators decides the dispute);<sup>39</sup> (5) the applicable law is the language of NAFTA, interpreted and applied in accordance with international law;<sup>40</sup> and (6) the final decision is binding on the parties.<sup>41</sup>

There are several advantages to arbitration under Chapter 11. First, international arbitration reduces the traditional costs associated with litigating in domestic courts.<sup>42</sup> Second, it lessens the risk that the jury may be technically incompetent and the judge may be sympathetic to the host country's government.<sup>43</sup> Third, each party appoints its own arbitrators to present its position in a neutral arbitral forum.<sup>44</sup> Finally, international law, rather than potentially-biased domestic law, applies to the dispute.<sup>45</sup>

The NAFTA investor-to-state mechanism differs slightly from dispute resolution systems in prior international agreements in that Chapter 11 allows individuals to sue national governments.<sup>46</sup> The negotiators involved in drafting the investor-

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36. *See id.* art. 1120(1), at 643.

37. *See id.* art. 1121, at 643-644.

38. *See id.* annex 1137.4, at 648.

39. *See id.* art. 1123, at 644.

40. *See id.* art. 1131(1), at 645.

41. *See id.* art. 1136(1), at 646.

42. *See Ganguly, supra* note 8, at 122.

43. *See id.* at 122-123.

44. *See id.* at 123.

45. *See id.* at 122-123.

46. *See Michelle Sforza & Mark Vallianatos, Briefing Paper, Ethyl Corporation v.s. Government of Canada: Now Investors Can Use NAFTA to Challenge Environmental Safeguards* (visited Oct. 24, 1999)



to-state mechanism opted to grant private standing so as to furnish investors with the greatest latitude to protect their interests.<sup>47</sup> The attorney for one Chapter 11 claims brought against Canada noted that Chapter 11 proceedings are held in secret to illicit greater cooperation and facilitate production of sensitive documents that would never be willingly disclosed in open court.<sup>48</sup>

#### V. INTERNATIONAL LAW: REGULATIONS AND EXPROPRIATION<sup>49</sup>

While Chapter 11 provides protection against direct and indirect expropriation, it does not define either term. Instead, it requires all claims be decided in accordance with international law.<sup>50</sup> International law defines "expropriation" as "a compulsory transfer of property rights."<sup>51</sup> "Indirect expropriation" is defined as a measure "'having effect equivalent to . . . expropriation,' 'any direct or indirect measure' of expropriation, 'any other measure having the same nature or the same effect against investments,' or 'all other measures whose effect is to dispossess, directly or indirectly, the investors.'"<sup>52</sup>

Although some regulations may have the effect of "indirect expropriation," traditional principles of international law and Chapter 11 specifically exclude environmental regulations from the host of governmental activity that can trigger liability. The first step in reaching this conclusion is to analyze NAFTA itself. Treaties "evidence an acceptance of a principle of international law by the parties to the treaty"<sup>53</sup> and, when available, are the primary source of international law.<sup>54</sup> NAFTA includes several provisions specifically designed to protect the environment.<sup>55</sup> Article 1114 states that "[n]othing in this Chapter shall be construed to prevent a Party from adopting, maintaining or

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<<http://www.citizen.org/pctrade/nafta/cases/Ethylbri.htm>>.

47. See Vandevelde, *supra* note 30, at 626.

48. See Wagner, *supra* note 4, at 476 n.38.

49. For an in-depth examination of NAFTA's Chapter 11 see *id.* at 474-481; indirect expropriation under domestic and international law see *id.* at 502-537; and NAFTA's specific provisions regarding the environment see *id.* at 478-480.

50. See NAFTA art. 1105(1), *supra* note 1, at 639.

51. *Amoco Int'l Fin. v. Government of the Islamic Republic of Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189 (1987), reprinted in 27 I.L.M. 1320, 1342-1343 (1998).

52. Wagner, *supra* note 4, at 473.

53. SORNARAJAH, *supra* note 4, at 73.

54. See *id.*

55. See NAFTA art. 1114, *supra* note 1, at 642.

enforcing any measure . . . [that ensures] that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”<sup>56</sup> Further, NAFTA’s Preamble provides that the Parties intend to “promote sustainable development,” to “strengthen the development and enforcement of environmental laws and regulations,” and to implement NAFTA’s goals in a manner “consistent with environmental protection and conservation.”<sup>57</sup>

In addition to NAFTA, the Parties adopted the North American Agreement on Environmental Cooperation (NAAEC),<sup>58</sup> also known as the “environmental side agreement” to NAFTA.<sup>59</sup> The NAAEC’s purpose was to “foster the protection and improvement of the environment . . . for the well-being of present and future generations.”<sup>60</sup> According to the Parties, the NAAEC’s objective was to “enhance compliance with, and enforcement of, environmental laws and regulations.”<sup>61</sup>

Custom is another generally accepted source of international law.<sup>62</sup> In this context, it is significant that the constitutions of nineteen nations make clear that governmental measures affecting the value of property will not be considered compensable takings.<sup>63</sup>

Judicial decisions, both domestic and international, are also commonly consulted in interpreting international agreements.<sup>64</sup> “[T]he general lack of more authoritative sources addressing the limits of indirect expropriation gives [judicial] decisions a special legitimacy.”<sup>65</sup> In the United States, the Fifth Amendment to the U.S. Constitution protects private property by guaranteeing that private property shall not “be taken for public use, without just

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56. *Id.*

57. NAFTA pmb., *supra* note 1, at 289, 297.

58. North American Agreement on Environmental Cooperation, Sept. 8, 9, 12, 14, 1993, Can.-Mex.-U.S., 32 I.L.M. 1480 (1993) [hereinafter NAAEC].

59. Wagner, *supra* note 4, at 479.

60. *Id.* at 480 (quoting NAAEC art. 1, *supra* note 58, at 1483).

61. NAAEC art. 1, *supra* note 58, at 1483.

62. See SORNARAJAH, *supra* note 4, at 74.

63. See Wagner, *supra* note 4, at 518 n.241 (citing the constitutions of Antigua and Barbuda, Bahamas, Barbados, Belize, Botswana, Dominica, Gambia, Grenada, Jamaica, Kenya, Malta, Mauritius, Papua New Guinea, Saint Christopher and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Tuvalu, Zambia, and Zimbabwe).

64. See generally *id.* at 518–519.

65. *Id.* at 519.

compensation.”<sup>66</sup> Until 1922, however, the U.S. Government was not required to pay compensation unless the “government took full title to private property.”<sup>67</sup> The U.S. Supreme Court discarded this standard in *Pennsylvania Coal Co. v. Mahon*,<sup>68</sup> establishing that “while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking,” and thus require compensation.<sup>69</sup>

Three factors are particularly significant in determining whether the government has, in fact, gone “too far.”<sup>70</sup> The first factor is “the nature of the governmental action.”<sup>71</sup> If the government “physically invade[s] or permanently appropriate[s]”<sup>72</sup> the property, compensation is automatically required.<sup>73</sup> Lesser interference, including regulation, however, normally does not require compensation.<sup>74</sup>

Second, the Supreme Court considers “the severity of the [governmental action’s] economic impact.”<sup>75</sup> A regulation generally constitutes a compensable taking if it “denies all economically beneficial or productive use” of the property.<sup>76</sup> “[M]ere diminution in the value of property, however serious, is insufficient to demonstrate a taking.”<sup>77</sup>

The final factor the Supreme Court considers in determining whether a regulation affects a compensable taking is the degree to which the regulation interferes with the claimant’s “reasonable investment-backed expectations.”<sup>78</sup> Thus, when property is

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66. U.S. CONST. amend. V.

67. *Lucas v. South Carolina Coastal Council*, 500 U.S. 1003, 1014 (1992).

68. 260 U.S. 393 (1922).

69. *Id.* at 415.

70. *Wagner*, *supra* note 4, at 503.

71. *Pennsylvania Coal*, 260 U.S. at 643.

72. *Id.*; see also *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 225 (1986).

73. *Lucas*, 505 U.S. at 1015.

74. See *Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602, 643 (1993). See also *Lucas*, 505 U.S. at 1022 (“[G]overnment may, consistent with the Takings Clause, affect property values by regulation without incurring an obligation to compensate—a reality we nowadays acknowledge explicitly with respect to the full scope of the State’s police power.”).

75. *Concrete Pipe*, 508 U.S. at 645.

76. *Lucas*, 505 U.S. at 1015–1019.

77. *Concrete Pipe*, 508 U.S. at 645 (citing *Village of Euclid v. Amber Realty Co.*, 272 U.S. 365, 384 (1926) (involving approximately 75% diminution in value)); see also *Lucas*, 505 U.S. at 1019 n.8 (“It is true that in at least some cases the landowner with 95% loss will get nothing, while the landowner with total loss will recover in full.”).

78. *Concrete Pipe*, 508 U.S. at 645.

already subject to extensive regulation, the owner has no reasonable expectation that new or changed regulations will not affect the property's value.<sup>79</sup>

In Canada, a plaintiff cannot recover the value of expropriated assets unless the regulation transfers a benefit from the original owner to the government.<sup>80</sup> The Canadian Charter of Rights and Freedoms, section 7, guarantees that "everyone has the right to life, liberty and security of the person . . .,"<sup>81</sup> but does not guarantee "the right to 'property.'"<sup>82</sup> Compensation is not required even when a Canadian regulation prohibits any and all use of the property.<sup>83</sup>

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79. See *id.* Applying this reasoning, courts reject compensation claims arising out of a vast array of laws protecting the environment and human health, including among others, laws requiring the cleanup of harmful chemical byproducts; see, e.g., *Atlas Corp. v. United States*, 895 F.2d 745, 756–758 (Fed. Cir. 1990) (holding that a law requiring uranium producers to clean up hazardous wastes did not require compensation even though the cleanup costs would exceed the property value and the government encouraged the companies to produce the uranium); restricting the sale and transport of endangered species; see, e.g., *United States v. Kepler*, 531 F.2d 796 (6th Cir. 1976); and prohibiting the exploitation of natural resources on private property for reasons of public health, safety, and welfare; see, e.g., *MacLeod v. County of Santa Clara*, 749 F.2d 541, 547–549 (9th Cir. 1984) (holding that the denial of a timber harvest permit does not deny all economically viable use of property).

80. See Michelle Swenarchuk, *Stomping on the Earth: Trade, Trade Law, and Canada's Ecological Footprints*, 5 BUFF. ENVTL. L.J. 197, 208, 209 (1998) ("[A]n aggrieved landowner must be able to demonstrate that not only has property been taken, but that the taking has also benefited the expropriating authority.").

81. CAN. CONST. (Constitution Act, 1982) pt. I (Canadian Charter of Rights and Freedoms), § 7.

82. Donald S. Macdonald, *Chapter 11 of NAFTA: What are the Implications for Sovereignty?*, 24 CAN.-U.S. L.J. 281, 282 (1998).

83. See Wagner, *supra* note 4, at 512 (discussing *Hartel Holdings Co. v. Council of Calgary* [1984] 8 D.L.R. 4th 321, 334 (Can.) (refusing to require compensation because the government's actions were "taken pursuant to a legitimate and valid planning purpose, . . . [therefore] the resulting detriment to the appellant [land owner] is one that must be endured in the public interest."); *Soo Mill & Lumber Co. v. Corporation of Sault Ste-Marie* [1975] 2 S.C.R. 78, 83 (Can.) (upholding a zoning regulation that "sterilized [the claimant's land] in respect of any effective use," because development freezes are not prohibited if enacted according to municipal plans or zoning regulations); *Sanbay Devs. Ltd. v. City of London* [1975] 45 D.L.R. 3d 403, 409 (Can.) (holding valid a zoning regulation that halted development of claimant's land)). Author Swenarchuk notes that:

Canadian by-laws, regulations, or other planning instruments do not generally involve a taking or transfer of the full use, title, or benefit of property. Therefore, if a landowner's ability to use or develop his or her property is constrained by a properly enacted zoning by-law, the landowner is not entitled to compensation, even if the zoning by-law causes a diminution in property value.

Swenarchuk, *supra* note 80, at 208–209.

Private property is protected, to various degrees, in both the United States and Canada without reference to the property owner's national origin. Property rights in Mexico, conversely, are conditioned upon foreign property owners agreeing to "consider themselves as nationals in respect to such property and bind themselves not to involve the protection of their governments in matters relating thereto; under penalty, in case of noncompliance, of forfeiture of the acquired property to the Nation."<sup>84</sup>

The most definitive statement regarding whether the economic impact of environmental regulations requires compensation comes from the Iran-United States Claims Tribunal. The Tribunal, which is one of the most important interpreters of international law,<sup>85</sup> has promulgated an impressive body of case law that influences the shaping of international law principles.<sup>86</sup> According to the Tribunal, a state is not liable for economic injury that is a consequence of "bona fide regulation within the accepted police power of states."<sup>87</sup>

Taken together, generally accepted principles of international law and NAFTA's specific provisions make clear that Chapter 11 does not require that states compensate foreign nationals for the economic impact of environmental regulations.

## VI. THE CLAIMS<sup>88</sup>

While several claims were recently filed under Chapter 11; two environmental claims, in particular, have received extensive review. The first is Metalclad's claim against Mexico. In 1995, the Mexican Government authorized Metalclad, a U.S. corporation, to take over and operate a toxic waste facility in the small Mexican

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84. MEX. CONST. tit. I, ch. I, art. 27.I, *translated in* XII CONSTITUTIONS OF THE COUNTRIES OF THE WORLD, *supra* note 17, at 25.

85. See Wagner, *supra* note 4, at 519.

86. See SORNARAJAH, *supra* note 4, at 80.

87. *Sedco, Inc. v. National Iranian Oil Co.*, 9 Iran-U.S. Cl. Trib. Rep. 248, 275 (1985). A state is not required to pay compensation for the loss of property resulting from "bona fide taxation, regulation, forfeiture for crime, or other action that is commonly accepted as within the police power of states." RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. g (1987); *see also* Wagner, *supra* note 4, at 518 n.240 (quoting SORNARAJAH, *supra* note 4, at 282-283 ("[A]ll measures affecting property rights' would not be an acceptable definition of a taking in international law 'for the simple reason that normal activities of states, such as taxation, affect property rights and cannot be expected to give rise to international concern.'")).

88. For more information regarding the Chapter 11 claims filed thus far, *see* Wagner, *supra* note 4, at 487-500.

town of San Luis Potosi.<sup>89</sup> In late 1996, after Metalclad invested \$20 million, the Governor of San Luis Potosi informed the company that the facility was an environmental hazard and would be shut down.<sup>90</sup> Although Metalclad was aware that the Mexican hazardous waste industry was highly regulated, on January 2, 1997, the company filed a Chapter 11 claim against the Mexican Government.<sup>91</sup> The complaint alleged that "having been denied the right to operate its constructed and permitted facility, [Metalclad's] property ha[d] therefore been, as a practical matter, expropriated."<sup>92</sup> The Governor's decision to halt the facility's operation was supported by a geological audit performed by environmental impact analysts at the University of San Luis Potosi, who found that the facility was located on an underground alluvial stream and could therefore contaminate the local water supply.<sup>93</sup>

The most controversial claim, however, was brought by Ethyl Corporation against Canada. In April 1997, Canada enacted a law banning Methylcyclopentadienyl Manganese Tricarbonyl (MMT), a gasoline additive designed to prevent engine knocking.<sup>94</sup> The Canadian Government enacted the ban in response to a Canadian Environmental Health Directorate report, which claimed that

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89. See *id.* at 488.

90. See *id.* Metalclad was aware that its "proposed business in Mexico [wa]s highly regulated and [wa]s subject to Mexican Environmental law." Metalclad SEC Filing, Form 10-KT, Apr. 1, 1997, Item 1(a), available at <<http://www.sec.gov/Archives/edgar/data/13547/0000013547-97-000008.txt>> [hereinafter Metalclad Apr. 1, 1997 SEC Filing]. Mexican environmental law regulates both the construction and operation of hazardous waste facilities and requires that operators conduct environmental impact studies and obtain permits from the National Institute of Ecology (INE) as well as from local and state agencies. See Wagner, *supra* note 4, at 488-489. Operation of such facilities and compliance with INE regulations is subject to continued monitoring by the Federal Attorney for the Protection of the Environment. See *id.* at 489.

91. See Metalclad SEC Filing, Form 10-Q, Nov. 20, 1998, pt. II, Item 1, available at <<http://www.sec.gov/Achives/edgar/data/13547/0000013547-98-000023.txt>> [hereinafter Metalclad Nov. 20, 1998 SEC Filing]. For a discussion of the significance of Metalclad's knowledge of the fact that the Mexican hazardous waste industry was highly regulated, see *infra* Part VIII.

92. Metalclad Apr. 1, 1997 SEC Filing Item 1(e), *supra* note 90. Metalclad claimed that the "expropriation" entitled the company to the fair market value of the facility in damages. See *id.*

93. See *id.*

94. See Manganese-based Fuel Additives Act, ch. 11, 1997 S.C. 1 (Can.).

MMT exposure causes serious neurological problems similar to mild Parkinson's Disease.<sup>95</sup>

In response, on April 14, 1997, Ethyl, a U.S. corporation, filed a \$250 million Chapter 11 claim against the Canadian Government on behalf of Ethyl's wholly-owned subsidiary, Ethyl Canada, the sole Canadian importer, processor, and distributor of MMT.<sup>96</sup> Ethyl alleged that the Canadian law constituted an expropriation of Ethyl's business in Canada and therefore required compensation under NAFTA's Article 1110.<sup>97</sup> Ethyl sought to recover its loss of sales and profits in Canada, loss of value of Ethyl Canada, loss of worldwide sales, the cost of reducing operations in Canada, expenses incurred in defending itself against Canada's allegations, lobbying to defeat the law, and loss of its goodwill both inside and outside Canada.<sup>98</sup> Ethyl also claimed that the legislative debate itself constituted an expropriation of its assets because public criticism of MMT damaged the company's reputation.<sup>99</sup>

In July 1998, the Canadian Government settled the Ethyl dispute.<sup>100</sup> Ethyl's tactics cost Canada \$19 million and forced the legislature to repeal the ban on MMT.<sup>101</sup>

## VII. SOLUTIONS

Although international law, NAFTA, and the NAAEC do not support challenges to environmental regulations, Chapter 11 claims can have a substantial chilling effect on governments' willingness to enact or enforce them.<sup>102</sup> If governments choose to defend such regulations, they risk having to pay huge compensation payments if the defense is unsuccessful.<sup>103</sup> Critics

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95. See ENVIRONMENTAL HEALTH DIRECTORATE, HEALTH CANADA, RISK ASSESSMENT FOR THE COMBUSTION PRODUCTS OF METHYLCYCLOPENTADIENYL MANGANESE TRICARBONYL (MMT) IN GASOLINE (Dec. 6, 1994) (on file with the *Loyola of Los Angeles International & Comparative Law Review*).

96. See Wagner, *supra* note 4, at 492.

97. See *id.* at 491-492.

98. See *id.* at 492.

99. See Sforza & Vallianatos, *supra* note 46.

100. See Wagner, *supra* note 4, at 495.

101. See Julie A. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 MINN. J. GLOBAL TRADE 55, 55 (1999) (referring to Order Amending the Schedule to the Manganese-based Fuel Additives Act, Sor/98-393, 132 C. Gaz. 2265 (pt. II 1998) (Can.)).

102. See Wagner, *supra* note 4, at 467.

103. See *id.* One commentator acknowledged this potentially detrimental effect by

claim that this effect poses a serious threat to environmental regulations and national sovereignty.<sup>104</sup> After much debate, legal scholars have advanced a spectrum of remedial measures. A few of the most popular solutions are introduced and critiqued below.

### *A. Adopt Interpretive Provisions*

To be sure that mere changes to laws, regulations, or policies that directly or indirectly affect the value of an asset are not sufficient to invoke Chapter 11, one commentator suggests that a series of interpretive provisions be drafted into NAFTA.<sup>105</sup> For example, the draft of a similar provision in the MAI includes an interpretive note providing that each country retains the right to adopt or modify its environmental regulations and specifying that "the provision does not require compensation for investment losses due to regulation . . . and other normal [governmental] activity in the public interest."<sup>106</sup>

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stating that:

This challenge to the sovereign powers of governments does not necessarily entail the direct taking away of the power to legislate in the interests of the populace. Indeed, it is the possibility of having to pay reparations for expropriation of the business of the private actor, as defined in these various treaties, which may serve as an even more effective indirect attack. The prospect of crushing liability claims or the chilling effect of the number and size of claims that may result under [investor-to-state dispute resolution mechanisms] can deter governments from legislating in the interest of the public.

Ganguly, *supra* note 8, at 119 (citations omitted). Ganguly discusses a host of new considerations that must be taken into account in the following example:

[I]f the government of a nation wants to implement legislation banning the advertising of hard alcohol on television, there are several prudential considerations that must be taken into account with the advent of the [investor-to-state dispute mechanism]. First, how many foreign investors can claim that the ban on advertising will result in a loss of sales and profits and hence will constitute a taking by the government? Second, how large will those claims be? Third, how likely is it that the arbitral panels will rule in favor of the investors? And finally, in the worst-case scenario where all claims are brought and the government loses all arbitrations, can the government afford to take that loss given the benefit to its people?

*Id.*

104. See generally, e.g., Wagner, *supra* note 4 (discussing critics' claims that Chapter 11 poses a real threat to environmental regulations and national sovereignty); Lawrence L. Herman, *Settlement of International Trade Disputes—Challenges to Sovereignty—A Canadian Perspective*, 24 CAN.-U.S. L.J. 121 (1998) (discussing the same).

105. See Herman, *supra* note 104, at 136. Canada favors utilizing this approach to clarify and limit NAFTA's investor-to-state provision. See Wagner, *supra* note 4, at 469.

106. Wagner, *supra* note 4, at 486 (alteration in original) (internal quotation marks omitted). Nevertheless, organizations such as Greenpeace International strongly oppose



Based on established international law principles and NAFTA's language, an interpretive note is not necessary to clarify Chapter 11's intended scope. Of the proposed solutions, however, it is the most appealing because it could be adopted quickly and would establish that, at least as between the United States, Canada, and Mexico, environmental regulations do not trigger Chapter 11 liability. An interpretive note, however, would not have the same effect as a published decision, which would establish globally applicable precedent.

### *B. Abandon the Investor-to-State Provision*

Another solution may be to abandon the notion of investor-to-state dispute settlement all together and return to the more traditional means of dispute settlement where investment disputes are arbitrated between governments only.<sup>107</sup> "When governments are the only entities with legal standing to bring a case challenging a regulation or other law under an international agreement, political and diplomatic pressures reduce the likelihood that frivolous lawsuits will be initiated."<sup>108</sup> Abandoning the investor-to-state provision, however, would not only sacrifice the cost savings associated therewith, but would also discourage cooperation between the parties and complicate discovery. Moreover, if the investor-to-state provision is discarded, individual investors' rights will be subject to political maneuvering, which may sacrifice many legitimate claims.

### *C. Establish a North American Trade Tribunal*

Alternatively, NAFTA might be re-written to provide that a supra-national court, similar to the highly successful European Court of Justice, shall adjudicate all investment disputes. In January 1992, the Joint Working Group of the American Bar Association, the Canadian Bar Association, and the Barra Mexicana (Group) produced an extensive report on NAFTA's dispute resolution provisions.<sup>109</sup> Significantly, the Group viewed

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the MAI because they continue to believe it will limit state sovereignty in dealing with a wide range of environmental and human health and safety measures. See Herman, *supra* note 104, at 135.

107. See Herman, *supra* note 104, at 136.

108. Sforza & Vallianatos, *supra* note 46.

109. See Joint ABA/CBA/BM Working Group on Dispute Settlement et al., *The Joint Working Group of the American Bar Association, the Canadian Bar Association, and the*

Chapter 11's features positively. Its members believed, however, that NAFTA would be improved were there a "North American Trade Tribunal" to adjudicate disputes.<sup>110</sup> Establishing such a tribunal, however, means abolishing the arbitral model and the benefits that flow therefrom.

Given NAFTA's stance on environmental protection, the overwhelming weight of authority suggesting that environmental regulations do not give rise to compensation claims, and the importance of establishing precedent in this area, Chapter 11 should be tested. Corrective measures need not be implemented now, nor must the Parties choose which solution is best, until the NAFTA arbitral tribunal decides a claim, or several claims.

### VIII. CONCLUSION: IT'S TIME TO ARBITRATE

Governments settle Chapter 11 claims for several reasons. First, while other international tribunals have decided that international law does not require compensation for the economic impact of legitimate regulations, in deciding this pivotal issue, it is conceivable that a tribunal convened to hear a Chapter 11 dispute could go either way. Second, although the arbitrators empanelled in the Chapter 11 process are expected to be independent and impartial, they *are* trade specialists. By nominating an arbitrator who shares the investor's nationality and political or economic philosophies, the investor may obtain an advantage.<sup>111</sup> Third,

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*Barra Mexicana Report on Dispute Settlement Procedures in the North American Free Trade Agreement*, 27 INT'L LAW. 831, 831 (1993).

110. See *id.* at 832.

111. See Ganguly, *supra* note 8, at 124. Ganguly further illustrates the potential conflict and dilemma in the NAFTA empanelling process by noting that:

Actual practice indicates pressure to advocate for the nominating party . . . . One would assume that since both the host country government and the investor get to appoint one arbitrator, those two arbitrators would cancel each other out because of the offsetting biases and create an effectively neutral tribunal with the neutral chairman in charge. However, in the case of [Chapter 11], the judgment of the panel can only be made by a majority of the panel. 'The need to obtain a majority often leads to a process of negotiation and compromise, in which the neutral feels obliged to trim or adjust his position in the search for a coalition with one of his colleagues—and ultimately perhaps to concur, reluctantly, in an award different from the one he might have preferred.' The danger in this process can affect either the investor or the host country government depending upon the discreet advocacy abilities of their respective appointees. But as the possible appointees are usually knowledgeable about trade and investment issues and not well versed in issue of public health concerns, there is a greater chance that the investor will appoint an arbitrator

because any investor can bring a claim and there is no cap on damages, the financial risks are staggering.

Even so, Chapter 11 is not a giant loophole. If NAFTA's signatories refused to settle these claims, a NAFTA tribunal would most likely uphold environmental regulations. An examination of Metalclad's claim, for example, exposes the fact that the company had no "investment-backed expectations" that its facility was regulation-proof. Metalclad was operating a hazardous waste facility in Mexico. It knew that its activities were subject to regulation and/or governmental abatement and made investments subject to that knowledge. As discussed above, international legal tribunals frequently refer to the factors the U.S. Supreme Court identified to decide whether indirect expropriation claims require compensation.<sup>112</sup> In *Concrete Pipe*, the Court held that the owner of property already subject to extensive regulation has no reasonable expectation that new or changed regulations will not affect the property's value.<sup>113</sup> Moreover, it is customary for international tribunals to reject expropriation claims where the governmental action seems "reasonable."<sup>114</sup> "If the reasons given are valid and bear some plausible relationship to the action taken, no attempt may be made to search deeper to see whether the State was activated by some illicit motive."<sup>115</sup> The fact that the Governor of San Luis Potosi halted Metalclad's operations to protect the local water supply seems reasonable beyond question. Therefore, if the NAFTA tribunal decides the Metalclad claim in accordance with U.S. takings jurisprudence, Metalclad will lose.

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with a trade and investment background and only agree to a neutral chairman with the same type of background. The government, in trying to appoint public health-oriented arbitrators, will be faced with the relative dearth of available choices and may have to concede the choice of background of the neutral arbitrator to the investor. Such a result would further prejudice the arbitral process against the government's case to protect its public health regulations.

*Id.* at 124-125 (internal citation omitted).

112. See Wagner, *supra* note 4, at 520.

113. See *Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602, 645 (1993).

114. *Id.*

115. G. C. Christie, *What Constitutes a Taking of Property Under International Law?*, 1962 BRIT. Y.B. INT'L L. 307, 338.

In sum, Chapter 11 provides protection against most forms of governmental expropriation, but the negative economic impact of environmental regulations does not trigger liability. International law, NAFTA, and the NAAEC provide support to assert that modifying Chapter 11 is not required—instead of settling these claims, it's time to arbitrate them.

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\* J.D. Candidate, 2001, Loyola Law School; B.A., 1994, Business Economics, *cum laude*, University of California, Los Angeles. I dedicate this Comment to my mother, Jan, whose selfless and enduring love has enriched my life immeasurably—she has made all my dreams come true. I want to thank Paul, my mother's husband and confidant, for being my friend and for his patience, wisdom, and guidance throughout the years. I also want to thank my cousin Lisa, whose love and friendship transcends family and means more to me each day. Grandma and Grandpa, I miss you, love you, and will always remember our time together. I owe a sincere thank you to Professor Laurence R. Helfer of Loyola Law School for providing the inspiration for this Comment and for his advice along the way. I especially must thank Lynn Harris, Editor-in-Chief of the *Loyola of Los Angeles International & Comparative Law Review*, Volume 22. She has truly exceptional talent—I am fortunate that she shared it and her friendship with me.

